

July 13, 2006

MEMORANDUM TO: State Investment Council

FROM: William G. Clark s/William G. Clark(crb)
Director

SUBJECT: **Proposed Private Equity Investments in Avenue Asia Special Situations IV, Onex Partners II and Credit Suisse Customized Fund Group (Separate Account)**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.12 (a) to report on three proposed private equity investments: a \$50 million commitment to Avenue Asia Special Situations IV ("Avenue"), a \$100 million commitment to Onex Partners II, ("Onex") and an additional \$250 million commitment to Credit Suisse Customized Funds Group ("CFIG").

Please note that these investments will be authorized pursuant to Articles 69 and 90 of the Council's regulations which became effective on June 20, 2005. The investment in Avenue will be considered a "debt-related investment" and the investments in Onex and CGIG will be considered as "buyout investments" as defined under N.J.A.C. 17:16-90.2 (a).

The Alternative Investments Procedures adopted by the Council on January 20, 2005 require any potential alternative investment opportunities to be identified and initially evaluated by the Head of Alternative Investments of the Division (myself in an acting capacity) and the applicable Asset Class Consultant (Strategic Investment Solutions for private equity, or "SIS") in coordination with the DOI Investment Committee (Ike Michaels acting as Deputy Director and myself).

As a result of internal and external sourcing, the DOI Investment Committee identified these proposed investments. As a result, SIS and Division staff proceeded to undertake extensive due diligence on these three proposed investments.

We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

Based on this due diligence, the Division has determined that each of the proposed investments meets the criteria for investments set forth in the Alternative Investment Procedures. A brief discussion of each investment follows below.

Avenue Asia Special Situations Fund IV will focus on special situations (distressed) investments in Asia in securities and assets believed to be undervalued, mainly concentrating on the non-performing loan markets. Currently it is estimated that the NPL's (non-performing loans) exceed \$550 billion in major Asian markets, excluding Japan. Many Asian countries, particularly China, are encouraging their banks to dispose of non-performing loans in order to improve their balance sheet strength. The fund is expected to focus on opportunities in China, India, the Philippines, Thailand and Indonesia. The fund will employ a flexible approach to making and structuring its investments. This approach is expected to allow the Fund to participate at the appropriate time and in the appropriate security type for each individual investment in order to maximize potential returns while minimizing principal risk. As a result, investments will include, but not be limited to, senior secured and unsecured debt, subordinated debt, bank debt, debt secured by real estate, convertible securities, and preferred and common stock or common stock equivalents.

Onex Partners II will focus on acquiring and building high quality businesses through active ownership by: (1) targeting attractive industries, often ones that are undergoing secular change or are in a state of flux; (2) partnering with quality management teams; (3) seeking diverse value creation opportunities, capitalizing on secular trends or participating in complex transactions not typically pursued by other private equity firms and; (4) applying reasonable capital structures to allow the operating companies to withstand cyclical downturns or unforeseen events. Generally, Onex will focus on investments in well-managed cash-flow positive companies for both platform and add-on acquisitions. Over its history Onex has invested approximately \$4.9 billion in 40 operating companies (comprising over 140 acquisitions) since 1984, of which 32 have been fully realized, substantially realized or generated publicly traded value.

The General Partner and the Manager are wholly owned affiliates of Onex Corporation, of which the Onex team owns 28% on a fully-diluted basis. Onex Corporation will be making a minimum commitment to Fund II of \$1.34 Billion or 40% of aggregate commitments.

Credit Suisse Customized Fund Investment Group (“CFIG”) is part of Credit Suisse’s Private Equity Group responsible for all private equity fund-related investment activities within the Firm. CFIG currently manages over \$11 billion of commitments in over 600 private equity funds and 150 co-investments. CFIG specializes in developing customized private equity investment programs that address the specific needs of investors.

In August 2005 New Jersey approved a separate account mandate with CFIG to source and commit \$200 million to buyout funds located in North America raising \$1 billion or less. Credit Suisse has implemented that mandate, providing New Jersey with commitments to approximately 12 funds spanning 3 vintage years. DOI staff has been very satisfied with the work Credit Suisse has done to implement this mandate and is recommending an additional commitment to the CFIG so that we may continue to expand our investments in funds in the \$1 billion and under size range.

The Division has recommended an additional allocation of \$250 million. Of that amount, \$200 million will be dedicated to a continuation of the program’s small to middle market buyout strategy, and \$50 million will remain available for Credit Suisse to invest on New Jersey’s behalf opportunistically in funds utilizing other strategies where Credit Suisse believes the investment will offer superior risk-adjusted returns. Some examples of other strategies may include venture capital, growth equity, infrastructure and biotech. Given the number of funds that Credit Suisse reviews each year, we believe that providing Credit Suisse with this added flexibility (subject to oversight and approval by the Division) will help to improve the portfolio’s returns by providing access to smaller private equity funds in a broader variety of strategies in addition to leveraged buyouts.

A formal written due diligence report for each of the proposed investments was sent to each member of the Investment Policy Committee of the Council on July 6, 2006, and a meeting of the Committee was held on July 10, 2006. In addition to the formal written due diligence reports, all other information obtained by the Division on these five investments was made available to the Investment Policy Committee.

After review of the extensive due diligence, the Investment Policy Committee of the Council decided to report on these proposed investments to the full Council pursuant to Step 4 of the Alternative Investments Procedures. Under these procedures, the Council may adopt or otherwise act on this report.

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We will work with representatives of the Division of Law and outside counsel to review and negotiate specific terms of the legal documents to govern each investment. In addition, each proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4). While we are confident that we will work through these issues, the potential exists that a successful resolution will not be reached with one or the other of these general partners.

We look forward to discussing these proposed private equity investments at the Council's July 20, 2006 meeting.

WGC: cpp
Attachments